

Submission

by

Business|NZ

to the

Finance & Expenditure Select Committee

on the

**Taxation (Relief, Refunds and
Miscellaneous Provisions) Bill**

14 February 2002

PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

TAXATION (RELIEF, REFUNDS AND MISCELLANEOUS PROVISIONS) BILL

DRAFT SUBMISSION BY BUSINESS NEW ZEALAND

14 FEBRUARY 2002

1. Introduction

- 1.1 This submission is made on behalf of Business New Zealand, incorporating regional employers' and manufacturers' organisations. The regional organisations consist of the Employers and Manufacturers Association (Northern), Employers and Manufacturers' Association (Central), Canterbury Manufacturers' Association, Canterbury Employers' Chambers of Commerce, and the Otago-Southland Employers' Association. Business New Zealand represents business and employer interests in all matters affecting those sectors.
- 1.2 One of Business New Zealand's key goals is to see the implementation of policies that would see New Zealand retain a first world national income and to regain a place in the top half of the OECD in per capita GDP terms. This is a goal that is shared by the Government. It is widely acknowledged that consistent, sustainable growth in real GDP per capita of well in excess of 4% per annum (and probably closer to 7-8%) would be required to achieve this goal in the medium term. Continued growth of around 2% (our long-run average) would only continue New Zealand's relative decline.
- 1.3 We welcome the moves proposed in this Bill to reduce the level of tax compliance costs for business but believe that the Bill does not go far enough to recognise the source of the greatest compliances costs for the business sector. Key policies that are having major impacts on business tax compliance costs are:
 - The introduction of the top personal tax rate of 39%
 - The wide interest rate margin between the "use-of-money" interest rate on overpaid tax and the interest rate for underpaid tax for provisional tax purposes
 - Fringe Benefits Tax
- 1.4 Rather than assessing whether these tax policy instruments are appropriate, the bill focuses on attempts to reduce the compliance impacts for business. Our organisation acknowledges that it is not easy for Government to reduce taxpayer compliance costs without a subsequent reduction in revenue. However, tax policy should measure the taxpayer compliance costs against the revenue benefit to New Zealand as a whole. The simplification measures contained in this bill and in the various Government proposals will always be of limited value until a more fundamental review of certain tax policies is undertaken and a robust process for establishing the compliance costs of new and existing policies is established.

2. Taxpayer Financial Relief

- 2.1 We support the proposed amendments to the Tax Administration Act 1994, which revise the current debt and hardship provisions. We particularly endorse the proposed intention not to pursue tax revenue where the revenue involved is small or the taxpayer would be placed in serious hardship. There is a need to ensure that finite IRD resources are focussed on maintaining the overall integrity of the tax system. This is likely to result in small shortfalls being written off where the costs of recovery are excessive with respect to the amount owing.
- 2.2 However, we would observe that in many cases taxpayer debts arise from taxpayers needs to pay creditors and employees in the need to stay in business. Taxpayers in this situation face the unenviable task of managing their debts and financial resources as best they can. Better IRD debt management procedures, combined with better relief from penalty rules for taxpayers that have obviously been complying with tax laws over the years would assist taxpayers before they get into the situation when it is necessary to contact Inland Revenue regarding debt write offs. Also, as we discuss further below, penal use of money interest rates for underpayments can simply exacerbate the situation.

3. Transfers of Excess Tax

- 3.1 Business New Zealand welcomes the move to clarify and improve the rules on transfers of excess tax. These rules will reduce the impact on companies of the high margin faced by companies under the use-of-money interest rate provisions. The high level of interest paid by companies if they underpay their provisional tax and the basis for that wide margin is flawed.
- 3.2 Publicly available material, such as the Government discussion document *Taxpayer compliance standards and penalties: a review*, shows that the margin between the underpayment and overpayment rates is designed to encourage taxpayers to pay their provisional tax, as opposed to being a pure charge for the use of the money¹
- 3.3 However, these provisions penalise companies that are able to borrow money at rates lower than the underpayment rate or do not have any borrowings. The high underpayment rate also penalises companies that experience significant annual volatility in profit levels and find forecasting profit levels 12 months ahead difficult. This is especially an issue for exporters since changes in the exchange rate can have a material impact on profit levels and make forecasting future profit levels very difficult. Over several years the provisional tax payments by these companies may meet the average provisional tax liability for the company but they will be required to pay penal interest to the Government because of the volatility in their earnings. The total interest these companies pay will be well in excess of the interest they earn in years when their tax is overpaid, because of the wide margin between the two interest rates. The changes proposed are welcome since they will allow excess tax to

¹ See Chapter 5 of the discussion document, in particular paragraphs 5.35 and 5.48.

be transferred to another period, assisting companies to avoid high interest rates on underpaid tax.

- 3.4 In May 2001 the 'More Time for Business' discussion document proposed much broader provisions for the transfer of excess tax, allowing for one taxpayer to transfer excess provisional tax payments to another taxpayer, through a pooling of provisional tax payments. The discussion document noted the Government at that date was paying 5.74% interest on overpaid tax and charging 12.62% interest on underpaid tax (now 11.93% and 4.83% respectively, a margin of 7.1% compared with the 6.88% interest margin prior to 8 November 2001) so there are quite strong incentives for businesses to explore tax pooling through intermediaries. While there are significant compliance costs involved in the pooling concept we believe the Bill should be widened to permit pooling arrangements.
- 3.5 However, we note that the changes involved are essentially an inevitable consequence of the rates used for under and overpayments. It is ironic that the Government is now proposing rules designed to get around its own unrealistic use of money interest rates, when in reality all it needs to do is have a better system of more closely aligning the use of interest rates with commercial rates available to taxpayers.
- 3.6 We believe the use of money interest rate unduly penalises the export sector, because of the inherent volatility in export earnings due to factors that are difficult to forecast and outside their control. The wide margin between the two rates of interest is excessive and generally leads most companies to overpay their provisional tax. The changes proposed in this Bill will help to alleviate the impact of that interest rate margin but don't go far enough. While we endorse the proposed pooling options, the businesses we represent would maintain that the better solution for them and hence New Zealand generally is a reduction in the margin between the two use-of-money interest rates.

4. Transfers of Holiday Pay

- 4.1 The Bill addresses the issue of transfers of holiday pay and other accumulated employee entitlements and whether they are deductible when a business is sold and employees are transferred to the purchaser. The Bill confirms holiday pay is deductible to the vendor but is quite restrictive on the situations where the purchaser can claim deductibility.
- 4.2 We believe that greater weight needs to be given to the ability of the purchaser to claim deductibility for transferred leave entitlements. Our reasons for adopting this view stem from the fact that normal accounting practice would recognise these deductions in relation to the purchaser and not the vendor. This avoids the need to make on-going adjustments in the tax reconciliation and also the possibility of inadvertently claiming the deduction again if the tax accounts are prepared from the accounting records.
- 4.3.1 We would also like to raise a point relating to the exception for associated persons. When a company restructures for commercial reasons we believe

that the benefit of these provisions should be extended in the same manner to entities regardless of whether they are associated. A case in point is the demutualisation of many of New Zealand's mutuals. Under the proposals they would have been forced to take the deduction over time rather than upfront. It seems anomalous to us that associated persons cannot get the same treatment in similar circumstances. As many large New Zealand taxpayers restructure for commercial reasons, such as to improve the efficiency of their New Zealand operations it does not seem right that their restructure will have a different outcome had the business been sold to someone else.

5. GST – Treatment of Warranty Payments From Non-registered Offshore Warrantors

- 5.1 The business sector welcomes the changes proposed in the Bill to overcome the inequitable situation following the Court of Appeal decision in *Suzuki* and clarify the treatment of warranty payments from non-registered offshore suppliers and alleviate the potential for a double charging of GST on some transactions.
- 5.2 However we are at a loss to understand why the amendment is not made retrospectively to 1 October 1986. Recent amendments to the GST Act were made retrospective to overturn a decision of the Court of Appeal that was considered contrary to most taxpayer's understanding of the law. The Court of Appeal decision in *Suzuki* went against what was thought to be the correct outcome, i.e. that no GST was payable on warranty receipts from non-resident suppliers of goods, yet the change to the law contained in this Bill does not correct that view retrospectively. This may mean that some of our members will be penalised for not returning GST on something that the Government accepts is not subject to GST. Thus, some New Zealand taxpayers will be double taxed on this amount. Ignoring the GST cost to New Zealand businesses, this will mean that they may have to face the costs of an IRD audit to collect the GST for the second time. This is very inefficient and anomalous with recent amendments. Business New Zealand therefore supports the application of legislation on a retrospective basis in this situation.

6. Multi-rate FBT – Low-income Rebate and the Multi-rate Calculation

- 6.1 Business New Zealand does not oppose the minor amendment proposed in the Bill but wishes to note its concerns with the greater compliance cost impacts, which have occurred following the introduction of the top personal tax rate of 39%. It is of real concern to our members that the complexity of the new multi-rate rules means that in certain cases it is uneconomic for businesses to take advantage of paying the lower FBT rates. Ironically the introduction of the new multi-rate rules comes at a time when the Government professes to be simplifying the tax system. The introduction of these rules contradicts the Government's stated aim of tax simplification.
- 6.2 Some of our members have called for FBT to be abandoned because the business compliance costs in collecting FBT are very high in comparison to

the total revenue raised from FBT. The Ministerial Panel on Business Compliance Costs also recognised these concerns when it made the following recommendation in July 2001:

The Government should consider undertaking a first principles review of Fringe Benefit Tax. The levying of FBT at a single rate and basing FBT on the depreciated cost of motor vehicles should be considered as part of the review.

- 6.3 We accept that consideration of FBT as a whole may be outside the Committee's brief in relation to this Bill. Nevertheless the issue of the costs faced by the business sector in complying with their FBT obligations is disproportionate to the revenue involved and we would ask the Committee to endorse the recommendation of the Ministerial Panel for a first principles review of FBT.

7. Removal of Tax Deductibility for Bribes

- 7.1 Business New Zealand notes the changes proposed are similar to recent amendments to the Crimes Act 1961. These amendments criminalized active bribery of foreign public officials. While bribery is not, of course, to be condoned, the payment of incentives is in some countries, it is understood, so endemic that well-intentioned legislation of this nature could have the effect of disadvantaging New Zealand individuals who are trying to do business there (to both their own and New Zealand's benefit).
- 7.2 We endorse strongly, therefore, the intention that the removal of tax deductibility does not to apply to payments made to expedite the performance of routine government action and where the value of the benefit is small.

8. Deduction for GST Adjustments on Fringe Benefits

- 8.1 Clause 17 of the Bill inserts a new section (DF 9) with the intention of disallowing a deduction for GST adjustments on fringe benefits. This amendment is listed in the commentary on the Bill under the provisions for business tax simplification (page 82) and appears confused in its explanation for the changes proposed.
- 8.2 Employers are currently required to calculate FBT on the GST inclusive value of the benefits provided to employees but most companies prepare their accounts on a GST exclusive basis. We can find no justification for why employers should not be entitled to a deduction of GST adjustments on fringe benefits and submit that Clause 17 should be withdrawn from the bill.

9. Other Tax Simplification Proposals

- 9.1 Business New Zealand is supportive of further changes proposed for tax simplification. These include proposals to:
- Remove interim imputation return requirements

- Raise the use-of-money interest threshold
- Remove the valuation requirement for trading stock less than \$5,000
- Allow the carry forward of losses and credits after a “spinout”

9.2 These changes will benefit both small and large businesses and are welcome in the effort to reduce tax compliance costs for the business sector.

10. Conclusion

10.1 Business New Zealand is supportive of the majority of the changes proposed in this Bill but notes that some of the changes proposed would not be necessary if the Government was willing to give greater recognition to business concerns with underlying tax principles. Business are not opposed to the principle of paying tax on a provisional basis but have major concerns with the use-of-money interest rates applied to over or underpaid provisional tax. Similarly there is recognition of the principles behind Fringe Benefit Tax but a concern that the excessive pursuit of tax revenue has resulted in high compliance costs for the business sector, which could be as great as the tax income recovered. This does not make sense from an economic viewpoint and a fundamental review of these policies is far more preferable than further incremental changes to tax legislation.

11. Recommendations

- 11.1 That the taxpayer financial relief provisions be implemented.
- 11.2 That the transfer of excess tax be permitted between unrelated taxpayers.
- 11.3 That clause 18 of the Bill be amended to allow the purchaser of a business to get a deduction for the cost of employee remuneration provisions acquired with a business when the provisions are paid to the employees in the ordinary course of events. In addition we would recommend that no distinction be made for associated persons when a business is sold as part of a restructure undertaken for commercial purposes.
- 11.4 That the amendment to GST treatment of warranty payments from non-registered offshore warrantors be implemented on a retrospective basis to 1 October 1986.
- 11.5 That the committee endorse the recommendations of the recommendations of the Ministerial Panel on Business Compliance Costs in relation to a first principles review of FBT and also continue to review options for reducing high tax compliance costs for the business sector.
- 11.6 That the amendment to remove deductibility for bribes does not to apply to payments made to expedite the performance of routine government action and where the value of the benefit is small.
- 11.7 That Clause 17 of the Bill not proceed.